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In the Supreme Court of the United States

OCTOBER TERM, 1931

No. 341

DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE, petitioner,

v.

CORONADO OIL AND GAS COMPANY

ON WRIT OF CERTIORARI TO THE COURT OF APPEALS OF THE DISTRICT OF COLUMBIA

SUPPLEMENTAL BRIEF FOR THE PETITIONER ON REARGUMENT

This case is here upon reargument. The petitioner relies upon the argument in its original brief, and in support thereof desires to add the following:

In the original brief (pp. 27–30) we pointed out that in *Gillespie* v. *Oklahoma*, 257 U. S. 501, it was conceded that the lessee was an instrumentality of the Federal Government, and that this circumstance distinguished the case from the case now at bar, not only because we make no such concession

here but because the exemption of Federal agencies and instrumentalities is absolute, whereas state agencies and instrumentalities enjoy a qualified exemption dependent upon their employment for strictly governmental purposes. Consequently, the concession made in the *Gillespie case* serves to destroy the controlling effect given to it in the court below, and leaves open for consideration in the instant case the contention that the lessee's income from its own share of the royalties is not exempt from Federal income tax because the business from which such income is derived is not governmental in character.

The implied immunity from taxation of the States by the United States, and of the United States by the States, arises from the provisions of the Constitution which contemplate the maintenance of the independence of the national and state governments within their respective spheres. The reasons underlying the principle mark the limits of its range, and the immunity does not extend to anything lying outside or beyond governmental functions and their exertion. *Indian Motocycle Co.* v. *United States,* 283 U. S. 570, 575–576.

The Federal Government, possessing only those powers conferred upon it by the express grant of the Constitution, and such other powers as may be necessary or proper for carrying them into execution, can not lawfully exercise any power which is not governmental. Within the limits of its sov-

ereignty, defined by the Constitution, the power of the national government is supreme, and it follows necessarily that all of its activities are entitled to absolute immunity from state taxation.

When the doctrine of implied immunity was first formulated, in *McCulloch* v. *Maryland,* 4 Wheat. 316, 436, it was declared:

> * * * the states have no power, by taxation or otherwise, to retard, impede, burden, or in any manner control, the operations of the constitutional laws enacted by congress to carry into execution the powers vested in the general government.

And in *California* v. *Pacific Railroad Co.,* 127 U. S. 1, 41, it was said:

> Recollecting the fundamental principle that the Constitution, laws and treaties of the United States are the supreme law of the land, it seems to us almost absurd to contend that a power given to a person or corporation by the United States may be subjected to taxation by a State. The power conferred emanates from, and is a portion of, the power of the government that confers it. To tax it, is not only derogatory to the dignity, but subversive of the powers of the government, and repugnant to its paramount sovereignty.

The same principle was stated in *Johnson* v. *Maryland,* 254 U. S. 51, 55–56:

> The decision in that case [*McCulloch* v. *Maryland*] was not put upon any considera-

> tion of degree but upon the entire absence of power on the part of the States to touch, in that way at least, the instrumentalities of the United States; 4 Wheat. 429, 430; and that is the law to-day. *Farmers & Mechanics Savings Bank* v. *Minnesota*, 232 U. S. 516, 525, 526.

Even in the *Gillespie case* it was said (p. 505): "The rule as to instrumentalities of the United States * * * is absolute in form." And in *Jaybird Mining Co.* v. *Weir*, 271 U. S. 609, 613, the same principle was emphasized: " * * * the federal government in all its activities is independent of state control."

In contrast, the powers of a State are both governmental and proprietary. Unlike the United States, it may exercise powers both of a governmental and of a nongovernmental character. In *Van Brocklin* v. *State of Tennessee*, 117 U. S. 151, 158, it was said:

> The United States do not and can not hold property, as a monarch may, for private or personal purposes. All the property and revenues of the United States must be held and applied, as all taxes, duties, imposts and excises must be laid and collected, "to pay the debts and provide for the common defence and general welfare of the United States."

The States, on the other hand, retain all the powers of a monarch except so far as they have been surrendered or limited by the provisions of

the Federal Constitution (*Hall* v. *Wisconsin*, 103 U. S. 5, 11), and may engage, directly or through agencies and instrumentalities, in activities governmental and nongovernmental in character. It follows that where the exemption from Federal taxation is predicated upon interference with the exercise of strictly governmental powers of the State, the inquiry must extend beyond the instrumentality sought to be taxed to its activities with which the imposition of the tax will interfere, and if these activities are not strictly governmental the tax will be sustained. (*South Carolina* v. *United States*, 199 U. S. 437, and authorities cited on page 30 of our original brief.)

Such inquiry in this case, we contend, discloses at once that the tax imposed upon income derived by the lessee from the sale of its own share of the oil and gas produced is imposed upon income derived by the lessee from the sale of its own property and the conduct of its own private business. It has been held that the State of Minnesota, in contracting for the removal of timber from lands received in its sovereign capacity under a grant from the United States to hold these in trust for its school fund, acts in its proprietary and not in its sovereign capacity. (*State* v. *Horr*, 165 Minn. 1, 5.) But in the case at bar we need not go so far. Assuming the lease to be an instrumentality of government, the lessee, in marketing its own share of the oil, does not act for the State in its sovereign

or governmental capacity. It acts solely on its own account, and for its own profit, in a purely private business undertaking.

The tax, being imposed upon the lessee's income from the sale of its own share of the oil and gas produced, is a tax not upon the lessee as the instrumentality of the State but upon the lessee's income or property. But taxation of the property of the agent is not always or generally taxation of the means. (*Clallam County* v. *United States*, 263 U. S. 341, 344; *Thomson* v. *Pacific Railroad*, 9 Wall. 579, 591.)

In *Susquehanna Power Co.* v. *Tax Commission*, 283 U. S. 291, this Court sustained a tax levied by the State of Maryland upon lands of a licensee of the Federal Power Commission. The Power Company there claimed that in constructing and operating its plant under a Federal license it was an agency or instrumentality of the Federal Government, and that the tax in question was impliedly prohibited by the Constitution. This Court said (pp. 294–295):

> Assuming, for present purposes, that the license of the Power Commission is a federal instrumentality, immune from taxation or other direct interference by the State, it does not follow that the property appellant uses in its power project is clothed with that immunity. The exemption of an instrumentality of one government from taxation by the other must be given such a practical con-

struction as will not unduly impair the taxing power of the one or the appropriate exercise of its functions by the other. *Metcalf & Eddy* v. *Mitchell*, 269 U. S. 514, 523, 524.

With that end in view, the distinction has long been taken between a privilege or franchise granted by the Government to a private corporation in order to effect some governmental purpose, and the property employed by the grantee in the exercise of the privilege, but for private business advantage. * * *

The present case is not only controlled by the earlier decisions of this Court, but it would be difficult to suppose any case in which the adverse effect of a tax upon a governmental purpose would be more remote or attenuated, or in which the asserted immunity would more seriously impair the sovereign power of the State to tax, than in this one.

Once the lessee in the case at bar receives its share of the oil and gas produced under the terms of the lease, it is entitled to dispose of its oil and gas, without accountability to the State, as its own property. No tax is imposed upon the production of its share, much less upon the production of the share which the State is entitled to receive. The lessee may do what it pleases with its share of the oil and gas, and the income which it derives therefrom is derived from its own property. In principle there is no distinction between this case and

Group No. 1 Oil Corporation v. *Bass*, 283 U. S. 279.

For the reasons urged in this and in our original brief, we submit that such income is not immune from Federal taxation by reason of any exemption implied from the provisions of the Constitution of the United States.

CONCLUSION

The decision of the court below should be reversed.

Respectfully submitted.

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